



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Larry D. Lisenbee

**SUBJECT: MONTHLY FINANCIAL REPORT
OCTOBER 2002**

DATE: December 3, 2002

Approved

Date

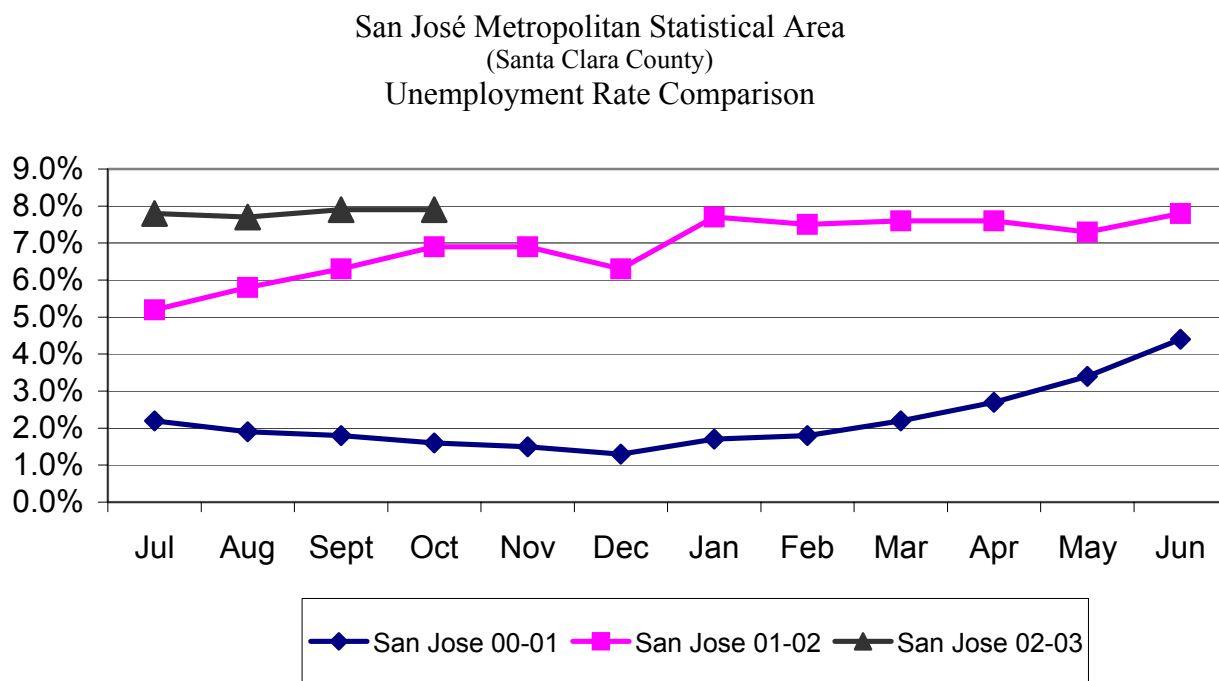
The Monthly Financial Report (MFR) for October has been jointly prepared by the City Manager's Budget Office and the Finance Department and is presented here for the City Council's review.

OVERVIEW

Through the first four months of the year the City's finances continued to be heavily impacted by the severe economic downturn plaguing the Valley. On an overall basis, revenue to the General Fund for October dropped from the prior year level for a fourth consecutive month. All of the City's economically sensitive revenues continued to perform poorly. Evidencing the tremendous falloff in local construction activity, all of the development-related revenue collections also continued their decline. Building, Planning, and Public Works development services cost-recovery revenue were 1.5%, 1.9%, and 16.0%, respectively, below budgeted levels, which already presumed extremely low activity levels. Construction taxes as well illustrated the state of the construction industry. Construction Excise Tax revenue dropped 6.7% below last year's depressed level, while Building and Structures Tax dropped by an even greater amount (12.6%).

Locally, the unemployment rate as well as the number of wage and salary jobs remain the strongest indicators of just how weak the local economy is. The Santa Clara County unemployment rate for October was unchanged from September's revised rate of 7.9%, and is still well above both the state and national rates (reported at 6.2% and 5.3%, respectively). The County rate is a full percentage above last October's already depressed post 9-11 rate, illustrating the continued severity of the economic decline in the area. The news concerning the number of jobs in the area for October, although mixed, continues to be discouraging. The total number of wage and salary jobs in the County was estimated at 965,100 (up by 1,200 from the revised September level of 963,900). In reality, this performance was largely driven by seasonal increases in local and state public education as well as services provided at private schools. In contrast however, manufacturing jobs, the bellweather of the local economy, dropped by another 2,800 jobs. This decline was driven primarily by losses in the all important communications equipment and electronic components sectors, which continue to show no sign whatsoever of emerging from the severe slump that has plagued them for over 18 months.

OVERVIEW (CONT'D.)



In light of poor current year revenue performance, and our review of weaker than anticipated final collection totals for last year, downward revenue adjustments to the 2002-2003 Adopted General Fund budget were recommended in October, as part of the City Manager's 2001-2002 Annual Report. Downward adjustments of \$15.0 million were approved by the City Council at that time.¹ Further, as was also discussed in the Annual Report, the 2003-2004 State Budget contained actions reducing City General Fund revenues by approximately \$1.0 million. The Council included in its October actions adjustments to the General Fund Adopted Budget to reflect that impact.

As we are all aware, the adjustments may not be the last necessitated by State budget balancing actions. The most recent report from the State's Legislative Analyst's Office (LAO), released within the last few weeks, indicates that the State faces a current year shortfall of at least \$6.1 billion dollars, despite actions taken in September to adopt a "balanced" State budget. In addition, the LAO also now projects that the State faces at least a \$21.1 billion shortfall in 2003-2004. That would almost equal the deficit which was supposedly eliminated in the just adopted State budget. A special session of the State Legislature has been called by the Governor for next week. The Governor also announced that his office would be releasing proposals for that session to reduce the current year budget by approximately \$5.0 billion. At this point, no formal proposals have been forwarded that would balance the State budget through cuts to local government revenue streams. We continue to be deeply concerned, however, that the State could decide to take budget-balancing actions that would involve additional significant cuts to local government revenue sources (e.g., Motor Vehicle In-Lieu, Public Library Funds, etc.) We will, of course, continue to monitor the State budget situation very closely.

¹ The downward adjustments were offset by higher than anticipated year-ending fund balance, and unanticipated revenue that will be available from the sale of surplus property.

OVERVIEW (CONT'D.)

In response to this situation, year-to-date actions by the City Council and Administration have been in keeping with the conservative fiscal practices that have served the City so well in the past. As mentioned earlier, downward revisions to a number of General Fund revenue estimates to reflect current conditions were recommended and approved by Council in October. These revisions re-aligned the budget to more current resource expectations, and our monitoring of General Fund collections through October indicates that if the current levels hold, we should end the year within the revised estimates.

Also in October, as part of the Annual Report actions, the City Council approved the establishment of an additional reserve to address future deficits in the amount of \$10.9 million, to go along with the General Fund Contingency Reserve and the Reserve for Economic Uncertainty (\$15.7 million) established last fall, and not utilized during the recent budget process. Finally, as reported in earlier MFRs, the Administration has maintained the hiring freeze in place since last November, and implemented new cost/position management plans, with departmental reduction savings targets for 2002-2003.

The Administration will, of course, continue to monitor our financial position closely, and recommend additional actions as they appear necessary.

REVENUES

General Fund revenues through October 2002 totaled \$164.2 million. This was a decrease of \$12.7 million (down 7.2%) from the October 2001 level of \$176.9 million. The drop is somewhat overstated, however, due to one-time settlement revenue received last year from the County of Santa Clara. Excluding this prior year one-time revenue, the decline was approximately 4.1% (down \$7.2 million). This decline reflects decreases in the following revenue categories: Property Tax, Sales Tax, Transient Occupancy Tax, Use of Money and Property, Revenue from the State of California, and Other Revenue. Declines in those revenue categories were only partially offset by increases in the following revenue categories: Franchise Fees, Revenue from Local Agencies, Departmental Charges, as well as Transfers and Reimbursements.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

The following discussion highlights General Fund activities through October:

KEY GENERAL FUND REVENUES
(\$000's)

<u>Revenue</u>	<u>2002-2003</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
Property Tax	\$ 86,278	\$ 12,165

Year-to-date Property Tax revenues reflect only collections in Unsecured Property Tax and the smallest property tax category, SB 813 Property Taxes (supplemental taxes).

Current and Prior Unsecured Property Taxes are driven by the value of personal property, typically equipment and machinery used by business and industry for manufacturing and production. Through October, Unsecured Property Tax receipts of \$11.9 million, reflected no growth over the prior year. This performance is better than anticipated and represents a rare piece of good news, as long as it holds. It should be noted however, that performance in this category over the past decade has been extremely volatile and subject to sharp changes as the economy shifts. Staff will continue to monitor this revenue source closely and work with the County to obtain additional information and assist with year-end estimates.

SB 813 payments through October tracked significantly below last year's collection level. Collections in this category, representing payments for taxes owed on recent housing re-sales, are typically a leading indicator of a drop in sales activities. The Adopted Budget anticipated a significant decline in this category. The estimate presumes a drop of 10.0% from the prior year level. We will need to watch closely to ascertain whether an additional downward adjustment may be necessary later in the year.

Consistent with previous years, no payments for Secured Property Taxes have been received through October. As reported in previous MFRs, though, the initial data from the County indicates that growth should approximate the expected 2002-2003 level.

<u>Revenue</u>	<u>2002-2003</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
Sales Tax	\$ 137,552	\$ 22,630

General Sales Tax receipts through October represent only State advance payments. Although General Sales Tax collections of \$21.3 million tracked 27.9% below the \$29.6 million collected in the prior year, these are formula-driven payments only, and are not necessarily indicative of

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Sales Tax (Cont'd.)	\$ 137,552	\$ 22,630

the actual performance of this revenue source. The next actual receipt information, representing the first quarter collections of the fiscal year will come in late December. As reported in previous MFRs and the Annual Report, the City received during this period (September) a quarterly Sales Tax report from the State reflecting the final quarter collections for last fiscal year. It was evident from that report that the City's Sales Tax performance continues to be very weak, with the 16.7% decline from the same quarter last year representing the fourth consecutive, double-digit, quarterly decline in General Sales Tax receipts. As a continuing reminder of just how hard this Valley has been hit, this decline was considerably greater than that experienced by the Bay Area (down 8.4%) and the State (down 1.4%).

Also as discussed previously, a conservative estimate for a 25.0% drop for that quarter was included in the year-end, final accruals for 2001-2002. While this latest General Sales Tax information does not change the 2001-2002 collection total recorded, the slightly improved performance at year-end does provide a small, one-time "buffer" of \$3.1 million in 2002-2003 to help offset the impact of a continued, weakened, General Fund revenue situation. A downward adjustment to the 2002-2003 General Sales Tax estimate of \$11.4 million was approved by City Council as a part of the Annual Report, bringing that estimate in line with actual 2001-2002 collections and reducing expectations to a flat growth projection for the year.

Information from MBIA MuniServices, the City's Sales Tax consultants, indicates that the decline in the City's Sales Tax receipts for the most recent quarter reflected poor performance in most economic sectors, but was led again, not surprisingly, by a sharp decline in the Business-to-Business category (down 35.2%). The following categories also suffered significant drops: Transportation (down 20.3%); Construction (down 6.5%); Food Products (down 6.4%); and General Retail (down 6.3%).

Within the Business-to-Business category, the greatest declines were related to office equipment (down 37.7%), electronic equipment (down 35.8%), and light industry (down 47.7%). Within the Transportation sector, the greatest decline was in service stations (down 41.8%) and new auto sales (down 9.8%). The new auto sales decline is indicative of a softening trend over the prior years' phenomenal growth levels.² The following lists the largest General Sales Tax sectors and their percentage of the total for the 2001-2002 fourth quarter (March through June economic activity): Business-to-Business at 30.6%; General Retail at 24.4%; Transportation at 21.4%; Food Products 12.9%; and Construction at 9.9%.

² For example, Motor Vehicle In-Lieu Fees 2001-2002 growth was 5.3% compared to the previous years: 9.8% growth in 2000-2001; 11.0% in 1999-2000; 9.5% growth in 1998-1999; and 10.0% growth in 1997-1998.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Transient Occupancy Tax	\$ 7,638	\$ 1,240

TOT collections of \$1.2 million through October were below last year's level of \$1.6 million. The drop is somewhat overstated due to prior year accruals. Even adjusted for that factor, however, the decline is still a cause for concern. Performance of this tax has not rebounded significantly from the depressed levels suffered in the months following the immediate aftermath of the September 11 events, and collections continue to be sluggish into the current fiscal year. The October occupancy rate was 55.8%, only slightly above the September rate of 51.9%. In addition, the monthly average room rate dropped to \$127.27 (October 2002) from \$145.44 (October 2001). The 2002-2003 Adopted Budget presumed growth in this revenue source (12.0%) over a higher than actually realized 2001-2002 collection level. Given current collection levels, it was very clear that the Adopted Budget level would not be achieved. As a result, a significant downward adjustment to the General Fund TOT estimate was recommended and approved by City Council in October. Continued collections at the current level would, however, necessitate a further downward reduction in this category. We will continue to monitor this situation very closely and recommend appropriate actions as part of the Mid-Year Budget Review.

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Franchise Fees	\$ 34,068	\$ 7,997

Franchise Fees collections of \$8.0 million were above the October 2001 collection level of \$6.2 million. This positive variance primarily reflects higher collections in Electric, Gas, and City-Generated Tow Franchise Fees. It should be noted, however, that these receipts are the result of formula-driven estimated payments from Pacific Gas & Electric (PG&E), based on collections in 2001-2002, and are not necessarily indicative of actual expected receipts. In April 2003, PG&E will calculate the actual Franchise Fees due in 2002-2003 based on calendar year 2002 activity. At this point, no downward adjustments are indicated.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2002-2003</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
Franchise Fees (Cont'd.)	\$ 34,068	\$ 7,997

Commercial Solid Waste Franchise Fees of \$1.9 million were approximately 4.7% higher (\$85,000) than the prior year level. This apparent positive performance is, however, due to the timing and booking of payments by the haulers and not indicative of actual expected receipts. Due to the 2001-2002 year-end performance of this Franchise Fee and current analysis related to the year-end collection level, a downward adjustment to the 2002-2003 revenue estimate was recommended and approved by City Council as part of the Annual Report. More recent projections indicate that this revenue may not even meet the revised budgeted level of \$9.1 million, primarily due the continued economic climate as well as to additional diversion related to the Food Waste Program and the Construction and Demolition Diversion Program. The Budget Office continues to work with the Environmental Services Department to analyze current year performance and assess whether further downward adjustments should be proposed.

<u>Revenue</u>	<u>2002-2003</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
Utility Tax	\$ 68,102	\$ 18,131

Utility Tax collections of \$18.1 million were 7.8% (down \$1.5 million) below last year's level of \$19.7 million. Due to the analysis of the 2001-2002 year-end performance, a downward adjustment to the current year estimate was approved by City Council as part of the Annual Report. At the adjusted level, this revenue source is currently expected to end the year within budget.

<u>Revenue</u>	<u>2002-2003</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
Licenses and Permits	\$ 61,911	\$ 18,871

Licenses and Permits revenue of \$18.9 million through October was 1.7% (\$309,000) above the prior year level. Cardroom Business Tax collections (\$1.5 million) were, however 31.0% (down \$669,000) below the prior year level of \$2.2 million. This October year-to-date performance

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Licenses and Permits (Cont'd.)	\$ 61,911	\$ 18,871

was primarily driven by a loss of revenue from Bay 101 related to its bankruptcy filing. Consequently, July's revenue was down approximately 60.0% from the prior year. Subsequently, August collections dropped by 19.0%; September by 11.0%; and October by 8.0%. The current budget allows for a drop of approximately 13.0%. At this point, no adjustments are recommended, but staff will continue to monitor this revenue source closely.

As a result of prior year-end performance analysis of the Disposal Facility Tax, a downward adjustment to the current year estimate was recommended and approved by City Council in October. More recent projections, however, indicate that this revenue may not meet the revised budgeted level of \$16.2 million, apparently due partially to market reactions to the removal of the Alternate Daily Cover exemption. A portion of the yard trimmings that typically went to City landfills in the past are now being transported to other locations. The Environmental Services Department (ESD) and the Budget Office will continue to monitor landfill activity, bringing forward a full report on findings to the City Council in the next few months. Further, the Budget Office will continue to work with ESD to analyze and assess whether any additional downward adjustments should be proposed.

Fire Permit revenue of \$2.35 million tracked below anticipated levels through October, although slightly above (2.9%) the prior year collection level of \$2.3 million. Current year revenue estimates were built assuming a continuation of the activity levels of last year, with the higher fee levels approved by City Council. Collections through October reflect activity levels that are below those anticipated in the budget. These fees will continue to be closely monitored and adjustments to the revenue estimate may be recommended as more information becomes available.

Building Permit revenues of \$5.4 million also tracked slightly below (down 1.5%) anticipated levels, but 14.4% above last year's level of \$4.7 million. Fee increases of approximately 12.0% were approved in the current budget along with a few new fees. It is too early to draw any definitive conclusions, but we believe this revenue source still has a chance to end the year within its budgeted level (\$16.55 million). As with all revenue categories, these fees will continue to be closely monitored and adjustments to the revenue estimate, if appropriate, recommended as more information becomes available.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Use of Money and Property	\$ 13,095	\$ 3,364

As anticipated, Use of Money and Property revenues of \$3.4 million were well below the prior year level of \$5.0 million, reflecting lower cash balances in many funds, including the General Fund, and lower interest earnings for all funds. The General Fund cash balance for October was down to \$186.6 million, compared to the prior year's \$221.9 million, a decline of 15.9% (down \$35.4 million). The current budget for General Fund interest earnings was built anticipating a drop in the average cash balance for the year (to \$185.0 million). Staff will continue to monitor this revenue source closely to see how actual balances and earnings compare to the budgeted assumptions, returning with recommended adjustments if necessary.

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Revenue from Local Agencies	\$ 41,629	\$ 14,559

Revenue from Local Agencies of \$14.6 million was 9.0% (\$1.2 million) above the prior year level of \$13.4 million. This variance was primarily driven by several earlier than anticipated payments, including the following (indicating the variance in receipts versus expected levels): Community Based Aftercare Program funding from the County (\$481,000), Enterprise Fund In-Lieu payment (\$302,000), payment from the County for the paramedic program (\$383,000), and animal services payments from other agencies (\$235,000). No change in the budgeted revenue estimate is currently believed necessary.

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Revenue from the State of California	\$ 58,213	\$ 13,841

Revenue from the State of California totaled \$13.8 million, representing a 9.5% decline from prior year collection level of \$15.3 million. The apparent decline primarily reflects the presence of a \$3.0 million accrual for open space activities, scheduled in 2001-2002 but yet to be paid, from Proposition 12 funds by the State.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Revenue from the State of California (Cont'd.)	\$ 58,213	\$ 13,841

This category includes Motor Vehicle In-Lieu Fee (MVLF) payments of \$14.1 million, reflecting year-to-date growth of 15.6% (\$1.9 million). However, we believe this level of growth to be overstated. The City has since also received its November MVLF payment from the State. That November payment of \$3.4 million was only 2.6% above the prior year-to-date performance level of \$17.0 million. The November year-to-date performance includes the deductions made by the State for Department of Motor Vehicles for administrative fees, placing year-to-date performance at a level that indicates a softening of vehicle sales. At this point, this revenue source is still anticipated to reach the budgeted level of \$52.5 million. Given the state of the local economy and the expected longer length of the recession, however, staff will continue to monitor this revenue stream closely and recommend adjustments if necessary.

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Departmental Charges		
-Public Works	\$ 6,356	\$ 1,966

Public Works October revenues of \$2.0 million were 16.0% below the anticipated level and 2.0% below the prior year level. Current year revenue estimates were built assuming a continuation of the activity levels of last year, with the higher fee levels approved by City Council. Activity levels have clearly not reached anticipated levels. As a result, the Department is implementing expenditure reduction strategies to prevent a shortfall by year-end. October performance reflects weak activity in the utility excavations, grading permits, and planned development permits categories. This situation requires close monitoring since all of the Public Works Fee Reserve was exhausted to offset shortfalls in 2001-2002. The Budget Office will continue to work with the Department to project the year-end collection level.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES

(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2002-2003 Estimate</u>	<u>YTD Actual</u>
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Departmental Charges (Cont'd.)

-Transportation	\$ 882	\$ 219
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Transportation revenues of \$219,000 tracked 35.5% below the prior year level of \$340,000. This performance was primarily driven by lower than anticipated from Residential Signal Review and miscellaneous fees and charges. Current projections indicate that this revenue source also may end the year at lower than budgeted levels.

<u>Revenue</u>	<u>2002-2003 Estimate</u>	<u>YTD Actual</u>
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-Planning	\$ 3,924	\$ 1,074
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Planning revenues of \$1.1 million tracked slightly below last year's level (down 3.9% or \$44,000) and below anticipated levels (down 1.9% or \$21,000). As with the other development-related revenue sources, current year revenue estimates were built assuming a continuation of the activity levels of last year along with higher fee levels approved by City Council. Revenues received in all categories are either at or above anticipated levels, except for the Non-Residential area of PD rezonings/rezonings, environmental clearance reports, site developments, and conditional use permits. The Budget Office will continue to work with the Department to analyze the drop in Non-Residential activity along with the increased activity related to Residential activity, determining whether the latter's level will continue and be sufficient to offset any shortfalls.

<u>Revenue</u>	<u>2002-2003 Estimate</u>	<u>YTD Actual</u>
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-Parks, Recreation, and Neighborhood Services	\$ 7,003	\$ 3,755
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Parks, Recreation, and Neighborhood Services (PRNS) revenues of \$3.7 million tracked 10.3% above the prior year level of \$3.4 million. This increase is primarily driven by growth in fee activities (\$183,000) and park revenue (\$91,000). This growth rate is likely not sustainable, but it is too early in the year to draw substantive conclusions regarding higher than budgeted collections. At this point, it is still assumed that this category will end the year at the budgeted level.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Other Revenue	\$ 11,590	\$ 4,421

Other Revenue collections of \$4.4 million were \$6.3 million below the prior year level of \$9.4 million. This decline from the prior year primarily reflects last year's booking of one-time settlement revenue from the County in the amount of \$5.5 million and budgetarily moving the Solid Waste Enforcement Fee to the Departmental Charges (prior year's October year-to-date level at \$488,000).

<u>Revenue</u>	2002-2003 <u>Estimate</u>	YTD <u>Actual</u>
Transfers and Reimbursements	\$ 79,326	\$ 34,366

Transfers and Reimbursement collections of \$34.4 million were 9.7% above the prior year level of \$31.3 million. This performance primarily reflects higher collections of operating and capital/special fund overhead, as well as earlier receipt of Municipal Water Rate of Return revenue. This performance was partially offset by lower receipts from Gas Tax Funds primarily due to the accrual made to 2001-2002.

EXPENDITURES

Through October, General Fund expenditures of \$213.2 million were 5.3% (\$10.8 million) above the prior year level of \$202.4 million. Encumbrances of \$67.2 million were 13.9% (\$8.2 million) above the prior year level of \$59.0 million. Expenditures and encumbrances (\$280.4 million) through October constitute 36.2% of the total 2002-2003 revised budgeted use of funds (\$774.0 million, excluding reserves).

With the exception of the Fire Department, and the City-wide Workers' Compensation Claims and City Insurance appropriations, individual and cumulative departmental and non-departmental expenditures appear to be within or below approved budgeted levels through

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

October. Overtime expenditures are tracking above anticipated levels, however, in the following departments: Employee Services; Fire; Finance; General Services; General Services Parks Maintenance; Office of the City Clerk; Parks, Recreation, and Neighborhood Services; Planning, Building, and Code Enforcement; Police; and Public Works. With the exception of Fire, though, the departments are generating sufficient salary savings to offset these higher overtime costs.

The following discussion highlights General Fund expenditures:

KEY GENERAL FUND EXPENDITURES
(\$000's)

<u>Department</u>	<u>2002-2003 Budget</u>	<u>YTD Actual</u>
Police	\$ 216,884	\$ 60,599

Police Department expenditures were lower than estimated levels through October. However, the Department's Personal Services expenditures tracked at higher than expected levels (29.12% compared to 28.8% par level), largely due to increased overtime usage for Airport security activities. Additional reimbursements from the Airport will be brought forward during the Mid-Year Budget Review to fully cover the costs of increased Airport security-related expenditures.

With the continuation of the Sworn Recruitment and Training Program, a total of 34 recruits are currently enrolled in the July 2002 Academy and are expected to be street-ready in May 2003.

Overtime expenditures through October were above expected levels at \$3.04 million or 38.1% of the budgeted level (compared to the estimated level of 28.8%). It is expected, though, that with the exception of additional Police overtime currently being experienced at the Airport, the Department will manage its overtime to remain within the budgeted level by year-end.

The compensatory time balance at the end of October is 213,799 hours for sworn personnel, an increase of 3,075 hours from the June 2002 balance of 210,724 hours. This level represents an increase of 4,003 hours from the October 2001 balance of 209,796 hours.

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

KEY GENERAL FUND EXPENDITURES
(\$000's) (Cont'd.)

<u>Department</u>	<u>2002-2003 Budget</u>	<u>YTD Actual</u>
Fire	\$ 108,709	\$ 33,314

Through October expenditures for the Fire Department continued to track significantly above budgeted levels. The Department's Personal Services expenditures remain the issue, tracking at much higher than budgeted levels, reflecting the combined impact of a higher than needed non-paramedic firefighter count, and a change in the method of paramedic staffing deployment. The Department currently has a total of 193 filled paramedics (120 front-line and 73 support), the highest level in the Department's history. The front-line total is, however, still 27 short of the 147 that are necessary to fully staff all apparatus. Last year, to address the paramedic staffing imbalance, and stay within their budget, the Department filled front-line paramedic duty requirements by deploying both front-line and support paramedic personnel. This process has been suspended since July to conduct an assessment of the impact of "dual role" practice. This suspension has, however, resulted in the Department's Personal Services tracking significantly higher than expected.

The Department has been working with the City Manager's Office on various strategies to reduce this gap. Coinciding with the end the Wildland Fire Season in early November, the Department redeployed personnel from four brush patrol and one water tender companies to provide coverage for Fire Engineer and Paramedic vacancies. The Department has also accelerated the accreditation process for 13 Paramedic Firefighters now in training. This should increase the number of front-line Paramedics by 13 by the end of March. In addition, the Department redeployed sworn personnel on administrative duties to the line, thereby reducing overtime usage for minimum staffing. These actions are expected to result in a \$1.5 million reduction in overtime usage, bringing the projected year-end shortfall to about \$3.7 million.

The City Manager's Office continues to work with the Department and the union on additional strategies to address both the short-term staffing issue and to develop long-term strategies to close the gap in front-line paramedics.

Current estimates indicate that the Department's level of Non-personal/Equipment expenditures are tracking at budgeted levels.

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

KEY GENERAL FUND EXPENDITURES
(\$000's) (Cont'd.)

<u>Department</u>	<u>2002-2003 Budget</u>	<u>YTD Actual</u>
Parks, Recreation, and Neighborhood Services	\$ 62,659	\$ 19,649

PRNS Personal Services expenditures through October tracked higher than anticipated (approximately 31.7%, compared to par level of 28.8%). In light of the relatively high level of vacancies in this department, the higher than anticipated year-to-date expenditures appear to reflect higher than budgeted expenditures for part-time staff and overtime to fill behind the vacant positions. The Budget Office is working with PRNS to assess what measures are needed to return both expenditures to budgeted levels, and achieve the savings required by the mandated cost/position management plan process (\$1.3 million). Non-personal/Equipment expenditures also still appear higher than anticipated through October, but the Department fully expects to stay within budgeted levels by year-end.

<u>Department</u>	<u>2002-2003 Budget</u>	<u>YTD Actual</u>
City-Wide Strategic Support	\$ 46,037	\$ 12,314

The City-Wide Strategic Support category includes funding for Workers' Compensation Claims and general City Insurance policy costs.

The City began to experience a spike in Worker's Compensation claims costs in the latter part of last year, and the 2001-2002 originally budgeted estimate was exceeded. Through October of this year, claims payments continued to track well above budgeted levels. Preliminary information indicates that the problem is not an increase in claims, but rather a significant increase in the cost per claim. For example, hospital payments have increased 158% while expenses related to surgeons increased by 53%. In addition, physician and drug costs have increased by 27%. Although an augmentation of \$500,000 to this appropriation was recommended and approved by City Council as part of the Annual Report, the most recent Employee Services Department projections indicate the likelihood of a shortfall of between \$1.5 and \$2.5 million by year-end. The Budget Office is working with the Employee Services

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

KEY GENERAL FUND EXPENDITURES (\$000's) (Cont'd.)

<u>Department</u>	<u>2002-2003 Budget</u>	<u>YTD Actual</u>
City-Wide Strategic Support (Cont'd.)	\$ 46,037	\$ 12,314

Department to provide additional information and analysis, and will report the findings through the Monthly Financial Report process.

It now appears that the City Insurance appropriation will also experience a shortfall of approximately \$149,000 by year-end. In June 2002, the City Council approved a memo from the Finance Department detailing this possible gap. The Budget Office is currently working with the Finance Department to determine the extent of the issue and will bring forward appropriate adjustment recommendations during the Mid-Year Budget Review.

CONTINGENCY RESERVE

Through October, the General Fund Contingency Reserve was down by \$62,500 from the 2002-2003 Adopted Budget level of \$24,549,175 (to \$24,486,675). This reflects the two revisions to the Contingency Reserve which have been approved during the first four months of the year:

- A decrease of \$27,500 to provide matching funds for an Office of Criminal Justice Planning "Domestic Violence" grant.
- A decrease of \$35,000 to provide for studies required to amend the General Plan related to the Almaden Youth Association Agreement.

OTHER FUNDS

Construction and Conveyance Tax Funds

Revenues for the Construction and Conveyance Tax Funds (C&C) are continuing to exceed budgeted expectations due to continued and unexpectedly high levels of activities in the local real estate market. The number of property transfers for all types of residences in the first four

OTHER FUNDS (Cont'd.)

Construction and Conveyance Tax Funds (Cont'd.)

months of fiscal year 2002-2003 totaled 3,345. This is a 19.9% increase from the same period of the fiscal year 2001-2002, which totaled 2,791. Nearly 97% of the total taxes received from C&C are comprised of Conveyance Receipts. Therefore, as Property Transfers increase, an increase in Conveyance Tax collections can be expected to follow.

Through October, \$6.1 million in actual tax revenues was received (37.8% of the 2002-2003 estimate of \$16 million). This collection is 4.4% higher than revenues received through October 2001. In addition to these revenues, the City has since received November Conveyance Tax receipts totaling \$2.1 million. This amount was an astounding 45% higher than the November 2001 amount of \$1.4 million. Since the 2002-2003 budgeted estimate anticipated a 39% decrease from the 2001-2002 collection level, collections year to date obviously have far outpaced expectations. While the news remains very positive in this area, we still are concerned that the prolonged economic downturn will eventually begin to negatively impact housing sales. Therefore, we continue to urge caution when interpreting receipt levels experienced to date.

Other Construction-Related Revenues

As mentioned previously, construction-related tax revenue collections remain depressed. The year-to-date total of the seven revenue sources monitored for this report is \$8.0 million, a decrease of 6.1% from the \$8.5 million collected through the same period last year. On an overall basis, this performance is not far off of adopted budget estimates that allow for a 6.2% drop from the prior year. Much of the collections reflect, however, unusually strong performance in a single month (August). The City is facing 10-year highs in San José's surplus capacity in industrial and commercial real estate. This will continue to have a very severe impact on new speculative development investment. It is expected, therefore, that construction-related taxes will demonstrate continued weak performance for a number of quarters to come. As a result, potentially significant reductions to both current year revenue estimates and projections for future collections in the out years of the five-year CIP now appear to be likely.

The major revenue sources – Construction Excise Taxes and Building and Structure Construction Taxes – continue to track below the prior year's already weak collection patterns. Year-to-date, Construction Excise Tax revenues equal \$4.5 million (32.9% of the current 2002-2003 estimate of \$13.66 million), representing a 6.7% decrease from last year's \$4.8 million received over the same period. The budgeted estimate for this category allows for an 8.2% drop in 2002-2003. However, as mentioned above, half of the total year-to-date collections were received in a single, atypical month (August). If August collections are adjusted to be in line with performance throughout the rest of the year, collections would be roughly 40% below last year's performance to date. Building and Structure Tax receipts through October totaled \$2.9 million (32.1% of the current 2002-2003 estimate of \$8.87 million), representing a decrease of 12.6% from the

OTHER FUNDS (Cont'd.)

Other Construction-Related Revenues (Cont'd.)

revenues collected through the same period last year (\$3.3 million). The budgeted estimate for this category allows for an 8.1% drop in 2002-2003. Again, however, without the unusually strong August performance, collections would have fallen much lower, to levels around 42% below 2001-2002 performance through October.

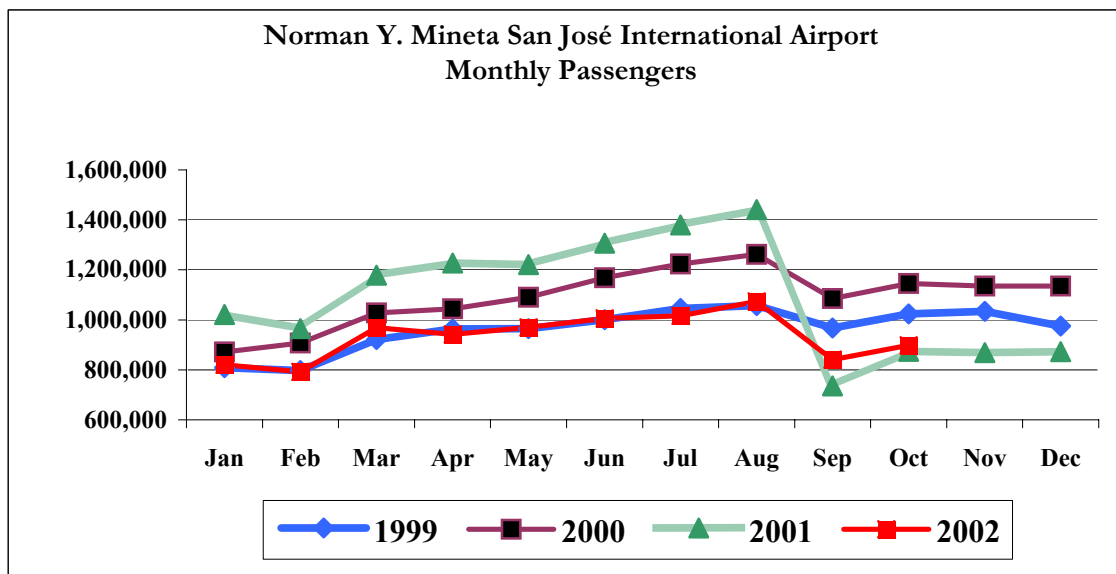
Among the smaller revenue sources in this categories, Sanitary Sewer Fees and Storm Drain Fees continued outperforming prior year data, while Residential Construction Taxes, Major Facilities Fees, and Service Connection Fees tracked below prior year collection patterns. Sanitary Sewer Fee receipts through October totaled \$445,000 (63.3% of the current 2002-2003 estimate of \$703,000), a level equal to 241% of last year's \$185,000 collected over the same period. In contrast, fee receipts through October for the Storm Drain Fees totaled \$164,000 (46.8% of the current 2002-2003 estimate of \$351,000), corresponding to 140.2% of the \$117,000 received over the same period last year. Residential Construction Tax receipts through October reached \$23,000 (14.8% of the current estimate of \$153,000), corresponding to 37.6% of last year's receipts of \$60,000 through October. Major Facilities Fee revenues through October totaled \$14,517 (5.8% of the current 2002-2003 estimate of \$250,000), representing a 21.7% decrease over the revenues collected through the same period last year (\$18,530). Service Connection Fee receipts through October totaled \$1,744 (0.5% of the current 2002-2003 estimate of \$320,000), 96.2% below collections through October 2001 (\$45,764). Because Service Connection Fee revenues recover actual costs to install new services, this revenue decline is coupled with a decline in costs, as well. Staff will continue to monitor these revenues closely.

Airport Funds

Activities at the Norman Y. Mineta San José International Airport (SJC) continue to be negatively impacted by the combined impact of the economy and the 9-11 events. Through October 2002, SJC enplaned and deplaned just over 3.8 million passengers, 13.5% less than the prior year. October results were very disappointing. The Airport served approximately 898,721 passengers. This was only a 2.9% increase over the depressed, post 9-11 October 2001 passenger activity levels. While Terminal C passenger activity increased 6.4% in monthly comparisons, activity for the fiscal year was lower by 12.2%. For Terminal A, October passenger activity increased by 1.2% but decreased by 14.2% for the fiscal year.

OTHER FUNDS (Cont'd.)

Airport Funds (Cont'd.)



Whereas for the first eight months of the calendar year, the Airport was tracking at 1999 levels, September and October have both dropped below that level. Activities are simply not showing signs of significant improvement. Major U.S. airlines continue the reduction of flight operations in response to the sharp declines in passenger activity. American Airlines' levels decreased from the prior fiscal year by 26.4%. Southwest, Alaska, Northwest, Mexicana as well as two Commuter airlines (Horizon Air and Skywest) were the only scheduled San José passenger carriers that experienced growth over last fiscal year. Skywest's fiscal year totals (+304.4%) continue to be greatly impacted by the airline's increased role as United's regional carrier to Los Angeles as part of the United's expanded Express service. Northwest and Horizon Air reported fiscal year increases of 18.5% and 74.6%, respectively. Beginning January 12, 2003, Southwest Airlines plans to offer a daily round-trip flight between SJC and Baltimore-Washington International Airport. The new flights will use a Boeing 737-700 with seating for approximately 130 passengers. Alaska Airlines launched its seasonal service to Puerto Vallarta and Cabo San Lucas on October 27. These flights depart four times a week on a Boeing 737 aircraft. Midwest Express Airlines will add service to San José beginning December 15 through a codeshare agreement with American Eagle. Midwest Express passengers originating in Milwaukee will be able to connect in Los Angeles with American Eagle flights to San José.

Fiscal year-to-date mail, freight and cargo poundage totaled nearly 104.3 million pounds, a 2.4% decrease from 2001-2002. The decrease is largely attributed to a 53.5% reduction in mail and a 20.2% drop in freight. However, international cargo and domestic cargo posted a 15.0% and 2.8% increase, respectively, from the prior year.

OTHER FUNDS (Cont'd.)

Airport Funds (Cont'd.)

Overall year-to-date revenue collections in the Airport Revenue Fund tracked at 96.0% of budgeted levels. Airfield, Terminal Concessions and Miscellaneous Rents, Parking and Roadway, and General and Non-aviation revenues were below expected budget levels. The decreases were partially offset by increases in Landing Fees, Terminal Rentals, and Petroleum Program revenues. Year-to-date revenues from the Airport Customer Facilities and Transportation Fee Fund are currently at 87.0% of the anticipated budget level. The Airport has established ongoing meetings with the rental car companies to both communicate activity levels as well as develop plans to meet service level needs.

As discussed previously, Airport Police overtime costs are anticipated to again exceed the current overtime allocation. The Airport and Police Departments are currently reviewing year-to-date overtime expenditures. It is anticipated that Airport funding will be recommended for allocation during the Mid-Year Budget Review process to fund the overtime costs.

The Airport Department operating fund expenditures through October, which includes the Airport Maintenance and Operation Fund and the Customer Facilities and Transportation Fee Fund, tracked below budgeted levels in both Personal and Non-personal/Equipment Services. Through October, the Airport had 63 vacancies, 31 of which were defunded for 2002-2003. The remaining 32 positions are funded and four of these are currently backfilled. Non-personal/Equipment expenditures through October, excluding encumbrances, totaled 20.4% of budget, and tracked below estimated levels of 25.2%. Encumbrances of \$17.2 million bring total Non-personal/Equipment Services commitments to 57.7% of budget.

Overall, the Airport expects that lower than anticipated revenue collections will necessitate downward mid-year adjustments in the \$3-4 million range. At this time, it is expected that these adjustments can be offset through the use of prior year surplus funds.

Transient Occupancy Tax Fund

TOT collections of \$1.9 million through October were well below last year's level of \$2.4 million. The drop is somewhat overstated, however, due to prior year accruals. But even adjusted for that factor, the decline through October performance is still cause for concern. Excluding accruals the decline was 10.3%. As was described above for General Fund Transient Occupancy Tax collections, performance of this tax has not rebounded significantly from the depressed levels suffered in the months following the immediate aftermath of the events, and collections have continued to be sluggish into the current fiscal year. For example, the October occupancy rate was 55.8%, only slightly above the September rate of 51.9%. In addition, the monthly average room rate dropped to \$127.27 (October 2002) from \$145.44 (October 2001). Given current collection levels, it is very clear that the Adopted Budget level will not be

OTHER FUNDS (Cont'd.)

Transient Occupancy Tax Fund (Cont'd.)

achieved. Due to the lower than expected 2001-2002 collection level of \$1.05 million, a reduction of \$262,740 for the Convention and Visitor Bureau and the Arts Groups allocation was recommended and approved by City Council as part of the Annual Report, as was a reduction of \$525,420 to the Conventions, Arts, and Entertainment Department (CAE).

Given current collection levels, it is likely that a significant downward adjustment to the Adopted TOT Fund revenue estimate will need to be recommended and implemented during the Mid-Year Budget Review. This action would result in further significant decreases to TOT Fund revenue available for allocation to the three TOT Fund recipients. The potential impact could be as much as a \$1.3 million allocation decrease for CAE, as well as \$650,000 decreases for the Convention and Visitor Bureau and Arts Groups. All three recipients have been informed and are currently developing plans to address the reduced funding levels.

Convention and Cultural Affairs Fund

Overall, revenues in the Convention and Cultural Affairs Fund are slightly lower than expected through October. Though Convention Center occupancy was as expected near 80.0%, the anticipated shortfall is currently estimated at \$500,000-\$800,000, primarily driven by lower concessionary income (e.g., food and beverage). The Conventions, Arts, and Entertainment Department is currently working to create a plan that would reduce both revenue and expenditure budgets. Proposed adjustments will be recommended during the Mid-Year Budget Review.

Unemployment Insurance Fund

Claims expenditures in the Unemployment Insurance Fund are now projected to end the year slightly over budgeted levels. Due to the high unemployment rate in Santa Clara County, combined with an increased benefit approved by the State effective at the beginning of the calendar year, expenditures are tracking above estimated levels. This fund will be monitored closely and a Mid-Year action possibly recommended.

CONCLUSION

Economic indicators and City revenue collections confirm that we continued to be mired in a severe local economic downturn, and that we should not expect any significant improvement in the immediate future.

Through prudent planning and decisive action, however, the City Council has placed the City in a relatively sound fiscal position to deal with the impacts of this situation. The most recent examples of such efforts were the adjustments approved recently through the Annual Report and reflected in the budget figures contained in this month's MFR. These adjustments provided revisions to the City's revenue estimates that were necessary both due to an analysis of last year's collections as well as trends apparent from our monitoring of current year activities.

In addition to actions adjusting revenue estimates, City Council also acted prudently to divert surplus prior year funds from the previously scheduled establishment of new projects, and instead fund a Reserve for the 2003-2004 Deficit to go with reserves previously established to address the downturn in collections. Taken together, these measures should prove invaluable in allowing the City to finish the current fiscal year within the revised budget, if, and it is a big if, the State does not take any actions to significantly reduce City revenue streams. The establishment of the reserves also gives us a significant head start in addressing what will clearly be a huge budget balancing challenge next year.

We will continue to monitor events closely, reporting monthly through this report. We will also bring recommendations for any additional adjustments that appear necessary or appropriate to either revenue or expenditure budgets to City Council through the Mid-year Budget Review.

LARRY D. LISENBEE
Budget Director